



First National City Bank Monthly Letter Business and Economic Conditions

New York, April, 1957

General Business Conditions

THE business picture continues to show both soft and strong spots. Industrial production in March has not made the usual seasonal gain, steel output is down, housing construction is still sluggish, and automobile sales are not showing the increases hoped for. Cutbacks in production to check inventory accumulation continue in some lines. On the other hand, employment, buying power, and consumption are firmly sustained. Scattered layoffs in consumer goods industries have been getting much publicity, but employers in 90 per cent of the nation's leading industrial centers reported to the U.S. Department of Labor late in March that they anticipate moderate increases in employment through mid-May. Backlogs in the capital goods industries hold at high levels, and, even where new orders have slowed, the pressure for more output and quicker shipment—as in structural steel—is still insistent.

On balance, the strong sectors in business offset the areas of weakness. They are producing a

generally sideways trend. This is particularly true when the over-all economy, including services and trade rather than industrial production alone, is considered. There is no evidence that the rise in gross national product has halted; certainly, it has not turned down.

Business sentiment has seemed, if anything, a little better than it was in February. This does not imply that people have suddenly become bullish again, or that buyers have started speculating or covering ahead once more. However, less talk is heard about the dangers of an imminent recession, and the security and commodity markets have behaved better than they did earlier in the year. Confidence was bolstered during the month by official reports that business men were planning to maintain expenditures for new plant and equipment at about the present record rate during the remainder of 1957. In another highly regarded survey, consumers reaffirmed their optimism and willingness to buy.

The slippage in industrial output—moderate though it is—is the principal soft spot in the over-all situation. Industrial production had been on a plateau prior to last month. In the five months from last October through February, the Federal Reserve index (seasonally adjusted, 1947-49 = 100) held steady at 146, except in December when it was 147. In March, however, steel mill operations declined and automobile output leveled off at a season when normally both should be increasing. Other industries also adjusted production schedules. The upswing in production of petroleum and other items probably will be insufficient to offset these losses, and a moderate downturn in the production index is likely.

Adjustment of Inventories and Output

In the steel industry, supplies of all but a few types of steel are now reported adequate and steel mill customers are reducing their commitments accordingly. Operations have been re-

CONTENTS

	PAGE
General Business Conditions	37
<i>Adjustment of Inventories and Output • Strength of Final Demand • Business Investment Maintained at Record • The Need for Adjustment</i>	
Corporate Earnings in 1956	39
<i>Trends in Manufacturing • Dispersion in Profits Trends</i>	
Corporate Financing in 1956	42
<i>Question of 1957</i>	
Public Debt Problems	43
<i>Overburden of Floating Debt • Moves on Savings Bonds • Rates Too High? • Experience Abroad</i>	
The Proliferating Public Payroll	46
<i>The Pattern of Growth • The Year 2069</i>	
Lord Beveridge's Second Thoughts	47
<i>The Basic Problem • Plans Gone Haywire</i>	

duced from over 97 per cent of capacity in January and February to about 93 per cent in March, although March is ordinarily one of the peak months of the year.

Automobile manufacturers recently cut production schedules for the second quarter to 1.6 million cars, about 7½ per cent below the levels originally announced, in order to avoid excessive inventories. Passenger car assemblies totaled about 1.8 million in the first quarter, and have been outrunning retail sales since early in the model year. As a result, dealers accumulated new car stocks totaling 730,000 by the end of February and added still more during March. Retail sales of new cars have been steady during the first quarter, but so far show no spring upsurge. Equally disappointing is the realization that sales are falling short of the 1956 rate.

The recent experience of steel and auto firms typifies the desire to avoid burdensome inventories, which has been a major factor in recent production trends. Whether a firm is cutting down its stocks or merely slowing the rate at which inventories build up, demand for current production is reduced. The latest figures on factory stocks show an increase averaging \$120 million a month in December, January, and February, seasonally adjusted, compared with an average monthly rise of \$607 million in the three preceding months. In other words, although inventories are still rising, the market for manufactured goods has been reduced nearly half a billion dollars a month just through the shift in inventory policy.

For the most part, purchasing agents have been proceeding cautiously. Despite a fairly steady rise in wholesale prices, no rush to beat further price boosts has developed. As shortages disappear, so does the need for precautionary stocks. In addition, trimming inventories has been a means of conserving working capital in a period of tight money and reduced corporate liquidity. For these reasons, it has become increasingly popular to "let the suppliers carry the inventory".

Strength of Final Demand

There is at least one good reason for thinking that the shift in inventory policy may not carry very far, namely, it comes at a time when final demand from consumers, business, and government is being maintained at peak rates. By practically any criterion, over-all business inventories at present are neither oppressively high nor dangerously unbalanced. To the extent that individual industries are able to carry out an adjustment while over-all demand is high, the possibility of a downward spiral is remote and the

chances for more "rolling readjustment" are enhanced. The impact is slight so long as final demand remains strong. Thus, the real issue in appraising the outlook is not the soft spots which reflect inventory adjustment or shifts in demand from one type of purchase to another. The important point is the strength of final demand.

During March, a succession of reports indicated a continued high level of expenditures by each of the three major sectors of the economy. Consumers appear to have carried into March the record volume of spending at retail stores rung up in the preceding three months. The annual Survey of Consumer Finances, conducted by the University of Michigan for the Federal Reserve Board, reveals that consumers are generally optimistic—both about the general outlook and their personal financial positions. To be sure, people are price conscious and cautious. Confirming market experience, the survey found that the proportion of consumers this year who say they are planning to buy a new car is no larger than last year, while potential home-buyers are significantly fewer. A greater share than in 1956 are interested in other major expenditures, including used cars, home improvements, furniture, and major appliances. Those who plan to buy expect to spend more than last year's purchasers did. On the whole, it is a picture of sustained, though not expansive, consumer buying interest.

Government spending is also on the rise. Over-all federal budget outlays in the first eight months of fiscal 1957 are up about 5 per cent over the previous year. The Defense Department's cash spending for military purposes in January, February and March averaged nearly one sixth ahead of last year, equivalent to a \$6 billion boost in the annual rate of spending. These accelerated outlays, reportedly concentrated in aircraft, guided missiles, and their operation and maintenance, may not be sustained, for they are already running not only above the \$36 billion rate scheduled in the 1957 budget but above the \$38 billion level proposed for the 1958 budget as well.

State and local governments are stepping up public works programs even though the effects of the highway program are being delayed longer than many persons expected. Outlays on all types of public construction (including federal) was at a new peak in the first two months of 1957, up 7 per cent from the fourth quarter rate and 10 per cent greater than a year earlier. Contracts for future public construction projects awarded in January and February were 9 per

cent larger than in the same months last year, according to F. W. Dodge tabulations.

Business Investment Maintained at Record

Business men are planning to spend \$37.4 billion on new plant and equipment during 1957, an increase of 6½ per cent over the record-breaking 1956 outlays. In manufacturing, over half of the outlays are earmarked for expansion of capacity. These capital expenditure programs are based not only on long-run expectations that such investment will prove profitable, but on an optimistic appraisal of 1957 business prospects. Manufacturers expect their sales to rise 8 per cent this year over 1956, public utilities anticipate a gain of 9 per cent, and wholesale and retail trade firms look for a 4 per cent increase in sales.

Most of the scheduled rise from 1956 to 1957 had already been accomplished by the first quarter of 1957. To achieve their investment goal for the full year, business men need to increase their spending less than 2 per cent further. Second quarter outlays are already scheduled at a \$38 billion annual rate, but these early expectations may not be fully realized, as has been the case in each of the last four quarters. Estimates of expenditure patterns in the second half of 1957 are still very tentative, but the best guess is that they will be close to the first quarter rate.

A year ago, a similar survey reported that business men expected to spend \$34.9 billion on plant and equipment in 1956, or 22 per cent more than in 1955. Actual expenditures came remarkably close to this prediction — within one half of one per cent — as the usual tendency to boost investment programs was offset by limitations on what was physically and financially feasible. Shortages of steel plate, pipe, and structural shapes, skilled labor, and, in some cases, long-term financing tended to inhibit those who tried to do too much too fast.

The same limiting factors apply this year. In addition, some observers have been concerned that firms might tend to space out, defer, or even cancel plant and equipment expenditures in a period of business stability and a profits squeeze. Several such shifts in capital spending plans have already been announced. However, a leading machine tool manufacturer, Mr. Walter Bailey, president of Warner & Swasey Company, observed recently:

The fact is that most of the programs canceled or postponed were long-range and in some cases overly ambitious projects. Normal expansion is continuing, and, what is more important to us, replacement of obsolete equipment now on plant floors is becoming more imperative than ever before.

The Need for Adjustment

Manufacturing investment and a number of other expansive factors in the economy have lost much of their kick, although they are still strong sustaining factors. One need not take a pessimistic view of the economy just because it does not set a new record each week, month, or quarter.

The dangers of pumping up our prosperity every time it falters or of seeking government aid every time an industry or group experiences a set-back were aptly set forth by Gabriel Hauge, Special Assistant to President Eisenhower, in a speech to the Economic Club of Detroit on March 11. He added:

Within our conception of prosperity, our task, it seems to me, is to widen the narrow path between inflation and deflation. We ought not to define so narrowly our goal of prosperity as to exclude temporary periods of adjustment. If we define any condition which is not inflationary as being deflationary, if we assume that all areas of the economy must persistently operate at full capacity, and if we require sellers' markets as the invariable objective, we shall have to resign ourselves to inflation as a national way of life.

We must adjust our thinking to the realization that optimum prosperity and growth — in the long run — are not the same thing as maximum prosperity and growth in the short run. Having so adjusted our thinking, confidence in the future is made more durable, and thereby it can become a more dependable and vigorous force for good times and for growth.

The economy may now be entering one of these "temporary periods of adjustment", reflecting shifts in inventory policy and production scheduling. Nevertheless, the basic strength of consumer, government, and business demand, discussed above, provides no basis for anticipating a serious downturn this year. There is nothing in the present picture inconsistent with the idea of a long, flat crest to the prolonged advance.

Corporate Earnings in 1956

Annual reports for 1956 now available from 3,485 corporations show combined net income after taxes of approximately \$19.2 billion, compared with \$18.5 billion in 1955, an increase of 4 per cent — compared with 3 per cent shown by our preliminary tabulation given last month. Increases are registered by almost all of the major industrial groups but are relatively small in most cases. The continued high levels of corporate activity and earnings reflect the new high records attained in national production, distribution, employment, personal income, capital investment, and plant expansion. They reflect also to some extent the rise in commodity prices which resulted in inventory profits.

Total dollar sales or revenues billed last year increased slightly more proportionately than did

net earnings, due to advances in operating costs for labor, materials, services, and taxes. This caused the over-all net profit margin to be slightly narrower than in 1955. The number of industry groups showing wider margins, however, was one third of the total.

Total net assets likewise increased proportionately more than net earnings, so that the over-all rate of return thereon was slightly lower. Such assets aggregated \$170 billion at the beginning of 1956, upon which the year's net income represented an average return of 11.3 per cent, compared with net assets in 1955 of \$155 billion and a return of 11.9 per cent. As in the case of profit margins, the industry groups showing higher rates of return were almost half the total.

For the manufacturing industries as a whole, net income increased 2 per cent. Excluding the important automobile and parts groups, where output and earnings were sharply curtailed, the reporting manufacturers showed net up 8 per cent. There were increases in the totals for mining, trade, public utilities, amusements and services, and finance, but a slight decrease for transportation. Following are the changes by main divisions, while the summary on the next page gives more detailed figures by major industry groups:

Net Income of Leading Corporations for the Years 1955 and 1956

(In Millions of Dollars)

No. of Cos.	Industry Divisions	Net Income After Taxes		Per Cent Change	% Margin on Sales	
		1955	1956		1955	1956
1,848	Manufacturing	\$12,508	\$12,724	+ 2	6.7	6.0
63	Mining	216	249	+15	10.3	10.8
204	Trade (ret. & wl.)	686	758	+10	3.7	2.6
224	Transportation	1,076	1,062	- 1	8.8	7.5
268	Public utilities	2,221	2,474	+11	13.4	13.5
116	Amuse., services	194	223	+15	5.1	5.4
767	Banks and finance	1,610	1,638	+ 2	—	—
3,485	Total	\$18,506	\$19,169	+ 4	6.8	6.3

Last year as usual the industry group totals tended to conceal wide differences in financial results experienced by the individual companies within each category because of diverse economic factors and their varying impact. In addition, the reported earnings were in many cases affected, as pointed out last month, by various accounting practices in connection with property depreciation, inventory valuation, and special adjustments which have a bearing on the comparability of corporate reports—both from year to year and among different companies.

The "book net assets"—also called "net worth" or "capital and surplus" or "shareholders' equity"—represent the excess of balance sheet assets over total liabilities. The amounts at which assets—particularly land, buildings, and equipment—are carried on the books stand in most

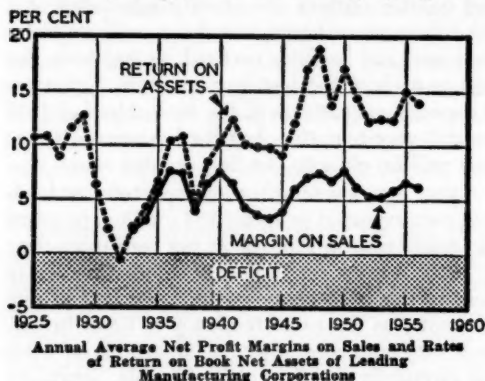
cases far below present-day values; thus the percentage rates of return thereon are higher than if computed on the basis of current replacement costs.

In comparing the two measures of profitability—rates of return on assets and profit margins on sales—it will be noted that high rates of return are not incompatible with low margins. With a high sales turnover, narrow margins may yield as good a return on capital as wide margins with low turnover.

Trends in Manufacturing

For total manufacturing, as for the grand total, the increase in net income last year fell somewhat short of the increases in sales and net assets. Reflecting this lag, the average net profit margin dipped from 6.7 per cent in 1955 to 6.0 per cent in '56, and the rate of return from 14.9 per cent to 13.9.

The longer term trends of both ratios, as shown by our previous tabulations in the April issues of this *Letter*, are given in the accompanying chart.



Looked at in this broad perspective, it will be seen that last year's average profit margin of 6.0 per cent was about in line with the average since the early '30s. It compares with around 7½ per cent in the best years of the late '30s and of the post World War II and Korean war boom, and with a low under 4 per cent during the World War period of price controls and excess profits taxes.

Rates of return on assets, on the other hand, while exhibiting much the same cyclical pattern, have tended to work higher over the longer term. Due partly to the lag in upvaluing corporate assets in line with higher replacement costs, the computed rates of return on book value are substantially higher than in the late '30s and even the late '20s. Taking the postwar period alone, the trend has been reversed; with huge amounts of new capital poured into industry without cor-

NET INCOME OF LEADING CORPORATIONS FOR THE YEARS 1955 AND 1956

(In Thousands of Dollars)

No. of Cos.	Industrial Groups	Reported Net Income After Taxes		Per Cent Change	Book Net Assets Jan. 1-a		% Return on Net Assets-a		% Margin on Sales-b	
		1955	1956		1955	1956	1955	1956	1955	1956
13	Baking	\$ 57,547	\$ 59,992	+ 4	\$ 477,751	\$ 495,058	12.0	12.1	2.4	2.3
12	Dairy products	90,445	98,606	+ 9	747,695	792,616	12.1	12.4	2.5	2.6
15	Meat packing	59,278	65,146	+10	875,899	847,829	6.8	7.7	0.8	0.9
23	Sugar	32,054	39,383	+24	577,587	590,486	5.5	6.7	2.2	2.7
85	Other food products	807,228	826,089	+ 6	2,614,478	2,758,064	11.8	11.8	4.0	4.2
15	Soft drinks	49,822	50,838	+ 2	347,975	366,565	14.3	13.9	8.6	8.6
24	Brewing	80,486	28,896	- 5	361,138	358,820	8.7	8.1	3.1	2.3
13	Distilling	77,504	76,167	- 2	1,188,755	1,211,126	6.5	6.3	2.5	2.0
18	Tobacco products	162,849	178,006	+ 6	1,392,783	1,445,268	11.7	12.0	5.0	5.1
80	Textile products	174,434	186,953	+ 7	2,777,440	2,811,483	6.3	6.6	4.1	3.6
48	Clothing and apparel	28,536	32,984	+16	415,192	427,753	6.9	7.7	2.1	2.2
25	Shoes, leather, etc.	40,894	41,928	+ 3	857,677	406,525	11.4	10.8	3.5	3.3
29	Tires, rubber products	230,694	233,895	+ 1	1,510,588	1,716,283	15.2	13.6	4.5	4.5
25	Lumber	107,882	111,010	+ 3	772,408	842,219	14.0	13.2	9.1	8.5
19	Furniture, wood products	29,084	28,947	- 1	225,667	245,319	12.9	11.8	5.1	5.2
78	Paper and allied products	424,579	468,413	+ 9	2,031,459	2,347,968	14.0	13.8	3.3	3.0
23	Printing and publishing	57,374	65,723	+15	442,385	469,054	18.0	14.0	4.3	5.3
68	Chemical products	1,009,881	983,706	- 3	5,778,290	6,325,396	17.5	15.6	10.0	9.1
22	Drugs and medicines	154,663	201,287	+30	832,450	899,256	18.6	22.4	10.5	11.9
22	Soap, cosmetics, etc.	104,859	114,050	+ 9	643,563	705,644	16.3	16.2	5.2	5.1
22	Paint and varnish	94,835	111,646	+18	580,688	687,467	16.3	17.5	6.7	6.9
101	Petroleum prod. and refining	3,769,462	3,144,822	-14	19,619,594	21,451,503	14.1	14.7	10.6	10.4
23	Cement	111,971	124,706	+11	551,208	640,664	20.3	19.5	16.5	16.4
16	Glass products	177,751	164,864	- 7	863,743	991,458	20.6	16.6	9.0	8.5
55	Other stone, clay products	197,725	212,004	+ 7	1,195,225	1,340,250	16.5	15.8	9.0	8.9
56	Iron and steel	1,092,721	1,107,767	+ 1	7,191,715	7,950,450	15.2	13.9	7.8	7.2
10	Agricultural implements	151,983	148,055	- 3	1,702,785	1,786,812	8.9	8.3	5.2	4.8
81	Building, heat, plumb., equip.	144,333	153,914	+ 7	1,274,046	1,376,697	11.3	11.2	4.9	4.6
94	Electrical equip., radio & tv.	519,543	602,163	+ 16	3,954,597	4,232,962	13.1	11.9	4.4	3.7
51	Hardware and tools	57,685	67,735	+17	511,420	554,039	11.3	12.2	5.7	6.3
35	Household appliances	71,156	77,460	+ 9	581,527	638,127	12.2	12.1	4.6	4.7
168	Machinery	263,426	264,194	- 3	2,262,958	2,447,387	11.6	14.9	5.7	6.3
32	Office equipment	124,631	144,455	+16	745,170	833,757	16.7	17.3	7.0	6.6
46	Nonferrous metals	551,194	661,860	+20	2,321,031	3,718,157	16.6	17.8	9.5	10.5
58	Instruments, photo. goods, etc.	194,382	214,599	+10	1,147,474	1,307,829	16.9	16.4	7.8	7.2
112	Other metal products	255,758	261,930	+ 2	1,997,716	2,166,720	12.8	12.1	4.8	4.3
13	Autos and trucks	1,742,977	1,113,066	-35	5,844,027	7,094,898	29.8	15.7	7.4	8.7
57	Automobile parts	215,820	198,882	- 8	1,356,739	1,494,913	15.9	13.3	5.3	5.0
21	Railway equipment	80,517	95,860	+19	943,475	971,371	8.5	9.9	4.7	4.4
33	Aircraft and parts	815,182	320,104	- 60	1,294,702	1,482,752	24.3	21.6	3.9	3.4
77	Misc. manufacturing	140,175	181,830	+ 30	1,876,110	1,477,898	10.2	10.3	4.6	4.6
1,848	Total manufacturing	12,503,320	12,724,280	+ 2	83,677,070	91,658,798	14.9	13.9	6.7	6.0
22	Coal mining - e	43,527	80,146	+84	766,424	801,871	5.7	10.0	4.2	7.3
81	Metal mining - e	115,908	116,553	+ 1	682,954	763,781	17.0	15.3	13.4	10.5
10	Other mining, quarrying - e	56,590	52,621	- 7	211,264	248,464	26.8	21.6	28.5	22.3
63	Total mining, quarrying	216,025	249,320	+15	1,660,642	1,809,106	18.0	13.8	10.2	10.8
27	Chain stores - food	97,474	123,379	+27	720,225	796,197	13.5	15.5	1.2	1.4
53	Chain stores - variety, etc.	134,469	137,227	+ 2	1,353,418	1,402,626	9.9	9.8	3.7	3.3
59	Department and specialty	182,629	196,866	+ 8	1,787,537	1,895,779	10.2	10.4	2.9	2.9
6	Mail order	202,180	208,018	+ 3	1,648,184	1,748,671	12.3	11.9	4.4	4.3
59	Wholesale and misc.	69,097	87,762	+27	766,316	798,503	9.0	11.0	1.8	2.0
204	Total trade	685,849	758,252	+10	6,275,675	6,641,776	10.9	11.3	2.7	2.6
116	Class 1 railroads - d	915,000	874,000	- 4	16,284,847	16,561,482	5.6	5.3	9.2	8.3
29	Traction and bus	19,191	21,014	+ 9	391,854	389,261	4.9	5.4	3.1	3.6
11	Shipping	32,870	47,011	+44	333,337	349,063	9.8	13.5	3.2	3.9
19	Air transport	67,433	70,608	+ 5	556,775	619,905	12.1	11.4	5.0	4.1
49	Misc. transportation	41,562	49,610	+19	312,133	350,891	13.3	14.1	6.9	6.4
224	Total transportation	1,075,856	1,062,243	- 1	17,878,996	18,270,602	6.0	5.8	8.3	7.5
237	Electric power, gas, etc. - d	1,456,698	1,599,963	+10	14,934,323	15,956,365	9.8	10.0	18.9	18.7
31	Telephone and telegraph - d	764,193	873,739	+14	8,082,936	9,265,407	9.5	9.4	12.6	13.2
268	Total public utilities	2,220,891	2,473,752	+11	22,867,264	25,221,772	9.7	9.8	13.4	13.5
21	Amusements	55,405	52,324	- 5	641,065	672,164	8.6	7.8	4.4	4.6
84	Restaurant and hotel	23,579	25,991	+ 10	225,452	236,170	10.5	11.0	8.9	8.9
42	Other business services	94,535	113,068	+20	510,143	554,838	18.5	20.4	7.4	7.5
18	Construction	20,911	31,778	+52	210,716	222,387	9.9	14.3	3.7	4.0
116	Total amusements, services, etc.	194,480	223,161	+15	1,587,381	1,685,509	12.3	13.2	5.1	5.4
376	Commercial banks	783,520	873,602	+11	8,224,725	8,863,126	9.5	9.9	—	—
62	Fire and casualty insurance	134,087	84,325	-54	3,331,847	3,769,263	5.5	2.3	—	—
109	Investment trusts - e	425,346	490,465	+18	3,174,927	10,116,007	5.2	4.7	—	—
72	Sales finance	204,363	280,057	+38	1,229,278	1,416,442	16.6	16.2	—	—
58	Real estate	12,667	14,385	+13	138,726	141,848	9.1	10.1	—	—
767	Total finance	1,609,983	1,682,784	+ 5	21,099,498	24,306,686	7.6	6.9	—	—
3,485	Grand total	\$18,506,404	\$19,168,792	+ 4	\$155,046,526	\$169,594,249	11.9	11.3	6.3	6.2

a-Book net assets at the beginning of each year are based upon the excess of total balance sheet assets over liabilities; the amounts at which assets are carried on the books are far below present-day values. b-Profit margins computed for all companies publishing sales or gross income figures, which represent about nine-tenths of total number of reporting companies, excluding the finance groups; includes income from investments and other sources as well as from sales. c-Net income is reported before depletion charges in some cases. d-Due to the large proportion of capital investment in the form of funded debt, rate of return on total property investment would be lower than that shown on net assets only. e-Figures in most cases exclude capital gains or losses on investments.

responding increases in profits, the rate of return has declined.

Dispersion in Profits Trends

The foregoing ratios, while useful for measuring over-all profits trends, have nevertheless the defect common to all composites of covering up too much—in this case the wide dispersion of profits trends within the sample. Before appraising the much talked of profits squeeze, it is essential to separate from the group those companies which suffered declines in net because of lower volume.

The fact is that, despite widespread complaints of rising costs, some 58 per cent of the reporting manufacturers had both higher sales and earnings, though not necessarily in the same proportion. Giving clearest evidence of a profits squeeze were the 21 per cent which, notwithstanding higher volume, made less money.

It is noteworthy that 6 per cent of the companies were able, despite lower sales, to improve their net. This leaves 15 per cent with both lower sales and earnings.

The following analysis, covering 1,316 manufacturing companies whose sales figures available for both '55 and '56 show changes between 30 per cent plus or minus, illustrates the dispersion of profits results relative to sales performance. The table gives the number of companies in each of twelve classifications based on percentage change in sales, the median or midpoint change in sales for each group, and the corresponding median change in net income.

Relative Changes in Sales and Net Income, Year 1956 as Compared with 1955, of 1,316 Manufacturing Corporations Which Reported Sales Changes Ranging from +30 Per Cent to -30 Per Cent

Number of Companies	Changes in Sales		Changes in Net Income
	Range	Median	Median
77	+26 to 30%	+28%	+49%
102	+21 to 25	+28	+28
155	+16 to 20	+18	+28
195	+11 to 15	+13	+16
275	+6 to 10	+8	+8
240	+0 to 5	+3	-1
116	-0 to 5	-3	-8
78	-6 to 10	-8	-26
82	-11 to 15	-13	-32
21	-16 to 20	-18	-38
17	-21 to 25	-23	-77
8	-26 to 30	-28	-91

These figures cover only the number of companies, with no weighting for relative size of company. Thus they differ from composite dollar figures, heavily weighted by the big industries—steel, automobiles, petroleum, etc.—and by the large individual producers. The use of the median or middle change for each group, rather than an arithmetic average, helps to minimize the effects of extreme and often erratic fluctuations.

The table shows at a glance the customary tendency for profits to swing more sharply than sales, bringing progressively wider profit margins for firms enjoying sales expansion and shrinking margins with sales contraction.

It will be seen, however, that it took fairly substantial sales increases last year to maintain or increase profits—and profit margins—in the face of rising costs. When sales increased 5 per cent or less, income and profit margins were barely sustained. Where sales actually declined, profits fell heavily.

Perhaps the most notable feature of the table, and one that goes far to explain the relatively favorable profits showing for the year, is the heavy bunching of companies in the groups registering significant sales increases. The success of American industry in expanding sales, and in maintaining profit margins in so many cases, is encouraging at a time when costs are a paramount problem for businessmen everywhere.

Corporate Financing in 1956

Business prospered in 1956, but record-breaking plant and equipment outlays, on top of increased working capital needs, strained the resources of many corporations. From estimates of the Council of Economic Advisers, it appears that nonfinancial corporations absorbed \$44 billion in funds from internal and external sources last year. The following table summarizes the principal uses and sources of these funds:

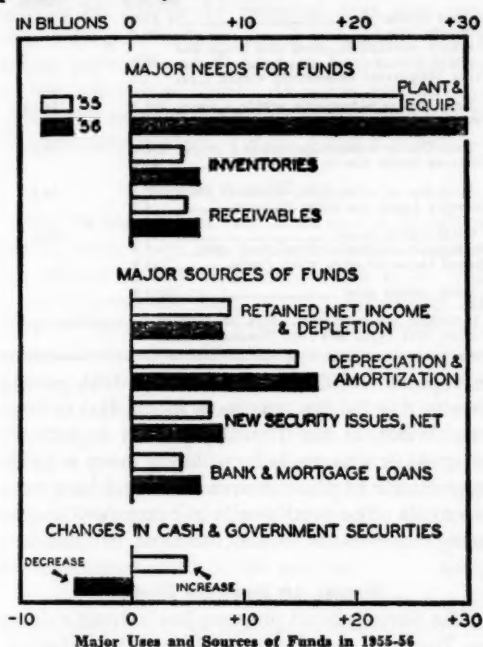
Estimated Uses and Sources of Funds of All U.S. Corporations, Excluding Banks and Insurance Companies

(In Billions of Dollars)				
Uses of Funds	1953	1954	1955	1956
Increase in cash & gov. sec.	\$ 2.1	\$ —	\$ 4.8	\$ —
Receivables, net	0.7	2.0	4.9	6.0
Inventories	1.6	2.3	4.6	6.0
Plant & equipment outlays	23.9	22.4	24.2	30.0
Other assets	0.2	0.1	0.9	2.0
Total uses	28.4	22.2	39.4	44.0
Sources of Funds				
Decrease in cash & gov. sec.	—	1.0	—	5.0
Bank & mortgage loans	0.5	-0.9	4.4	6.0
Federal income tax liability	0.4	-3.5	2.8	-1.0
Other liabilities	2.2	0.3	1.7	1.5
New security issues, net	7.1	5.9	7.0	8.0
Retained net income & depletion	6.5	5.7	8.8	8.0
Depreciation & amortization	11.8	13.3	14.8	16.5
Discrepancy—not reported	-0.1	0.4	-0.1	—
Total sources	28.4	22.2	39.4	44.0

Sources: U.S. Department of Commerce and Council of Economic Advisers.

To finance their current needs as well as capital projects, corporations drew upon liquid assets, increased bank borrowings, and enlarged new security offerings. Holdings of cash and U.S. Government securities were reduced \$5 billion, in sharp contrast to 1955 when \$4.8 billion was added to such holdings. The ratio of cash and governments to current liabilities—the common

measure of liquidity — stood at 0.46 on September 30, 1956 (the latest date available) compared to 0.53 a year earlier.



More working capital was tied up in inventories and receivables, influenced by record production and sales volumes, rising prices, and (in the case of receivables) slower collections. Both receivables and inventories increased more than in 1955. Accrual of funds to meet federal income taxes had provided \$2.8 billion of funds in 1955, but last year — with the requirement of advance tax payments for larger corporations — there was a net drain of \$1.0 billion from this source.

Outlays for modernization and expansion of plant and equipment, up nearly one fourth over 1955 to \$30 billion, were the biggest source of financial strain. The \$16.5 billion available from depreciation and amortization of existing facilities, while up \$1.7 billion from 1955, fell far short of supplying the funds needed.

Retained income and depletion allowances provided \$8 billion — a decline of \$800 million from the preceding year, reflecting a more liberal dividend pay-out.

Despite the large funds generated internally, business last year was forced to rely more heavily than ever before on banks and capital markets — to the extent of \$14 billion, against \$11.4 billion in 1955. Bank loans and mortgages provided \$6 billion, against \$4.4 billion. New security issues gave proceeds, net of refundings, of \$8 billion,

against \$7 billion in '55, with the largest portion of the total, as well as of the increase, coming from bond offerings, though sales of convertible debentures and common stock increased moderately to build equity as a basis for credit.

Question of 1957

Without an attempt to prophesy what will happen in corporate finance later this year, it is possible to note some of the broader influences on sources and uses of corporate funds in 1957. Because of the drop in corporate liquidity in 1956, corporations are less willing and able to cut their cash and government security holdings in order to meet demands for funds. Heavy new security offerings during the first quarter, as well as deliberate efforts to hold down inventory, aided repayments of bank borrowings in January and February and bolstered liquid assets to meet the strain of March tax payments.

A new Securities and Exchange Commission survey on long-term financing intentions shows that manufacturing and public utility corporations plan to increase stock and bond issues from \$6.3 billion in 1956 to \$6.9 billion in 1957. Less plant outlays are expected to be financed with bank loans, \$1.4 billion against \$1.6 billion in 1956. Bond financing, the greater part by public utilities, is expected to rise from \$4.8 to \$5.2 billion and new stock issues from \$1.4 to \$1.7 billion.

Despite the prospect of some easing of pressure for funds in the manufacturing sector, as seen in the SEC survey, evidence of a continuing desire to husband cash resources appears in a tendency of corporations to exercise more caution in dividend policy and, where acceptable to shareholders, to make distributions in stock.

Public Debt Problems

Moving to rebuild its depleted cash balances in anticipation of April and May deficits, the Treasury on March 28 raised \$3.3 billion by the sale of additional amounts of the securities used in the February refunding: \$842 million of the 3½ per cent notes due May 15, 1960 and \$2,437 million of the 3½ per cent certificates due February 14, 1958. At the close of March the 3½ per cent notes were trading in the market at 100%, the 3½ per cent certificates at 100.

Since there is a modest surplus indicated in the budget, it is surprising to many that the Treasury's cash balance should be under strain, particularly at the close of a quarter which brought more revenues into the Treasury than ever before. Moreover, apart from the revenues, the Treasury had raised \$1.1 billion from Janu-

ary 31 to March 14 by increasing weekly Treasury bill issues.

The trouble is that money has been pouring out as fast as it has been coming in. Military spending has been running beyond budget estimates. The Treasury has had to put up cash to redeem noninterest-bearing notes held by the International Monetary Fund which needed the money for lending to its member nations. More holders of government securities have been exercising their rights to cash them in, to cover business needs in a tighter money market, to help pay tax bills, or to take advantage of better investment opportunities. The Savings bond program shows a weakening trend of sales and a rising rate of redemptions, particularly on series F and G Savings bonds.

Overburden of Floating Debt

Most important, perhaps, the March surplus revenues, the heaviest of the year, were largely committed in advance to the repayment of \$4.2 billion tax anticipation certificates and bills sold last year. Thus, they provided almost no relief to the Treasury's cash problem. The experience is a salutary reminder that a public debt composed so largely of short-term and demand obligations gives the economy means of escape from a restrictive credit policy.

The Treasury's emphasis on the issue of Treasury bills, tax anticipation obligations and other short-term securities has reflected its anxiety to avoid competing for long term funds with the home mortgage market, industry and municipalities. Nevertheless, as long as the Federal Government spends so much and develops so little surplus for debt retirement, the Treasury has to raise money in some area of the market. Wherever it goes is apt to become a focus of pressure.

Meanwhile, the public debt gets shorter and shorter with every passing day. At the close of March, as the following table shows, \$176.4 billion or 77.7 per cent of all public issues came due within five years. Only \$4.3 billion or 1.9 per cent was out beyond twenty years. Going back to December 31, 1951, before the Truman Administration put out the first postwar marketable bond issue, the proportion of public issues due within five years was slightly smaller, 77.3 per cent, and \$8.8 billion or 4.0 per cent of the debt was made up of issues still over twenty years to maturity. We have not held our own in the five and one quarter years since then.

The problem of reconstructing the debt to cut down the burden of early maturities is unquestionably a big one. As Under Secretary of the Treasury W. Randolph Burgess pointed out

Structure of U.S. Public Debt, March 31, 1957

	Amounts in Billions	Percentage of Public Issues
Savings bonds	\$ 55.4	
Treasury bills	25.3	
Treasury certificates, notes and bonds due within 1 year	40.9	
Other obligations redeemable within 1 yr.	1.1	
Total due or redeemable within 1 year.	122.9	64.1%
Treasury notes and bonds due in 1-5 yrs.*	58.5	
Total due or redeemable within 5 years*	176.4	77.7
Treasury bonds due in 5-20 years	46.4	
Total due or redeemable within 20 years	222.8	96.1
Treasury bonds due after 20 years	4.3	
Total public issues	227.1	100.0
Noninterest-bearing and matured debt	2.3	
Special issues to govt. trust funds	45.9	
Total public debt	\$275.3	

* Including nonmarketable 2½% of 1975-80, convertible on demand into 1½% five year Treasury notes.

in September 1953, "with this huge debt, getting shorter day by day, you have to run fast to keep even." But, as the Treasury proved in 1953-55, progress can be made by utilizing every suitable opportunity to place intermediate and long term securities. The need now is to bring debt lengthening once more to the forefront of Treasury goals.

Moves on Savings Bonds

The Savings bond program has become a drain on Treasury cash because of the dissatisfaction of holders with rates of return offered. To meet this the Treasury has a two-pronged solution. The Congress has been asked to approve a boost in the rate paid on series E and H bonds from 3 to 3½ per cent. At the same time the limit on an individual's holdings is to be cut from \$20,000 to \$10,000 a year. In and out of Congress there is general agreement that the current 3 per cent rate, adopted in May 1952 when marketable long term Treasury bonds were yielding around 2½ per cent, is no longer appropriate in an environment where marketable Treasury bonds yield from 3¼ to 3½ per cent and the strongest business corporations are paying 4¼ to 4½ per cent to sell their bonds.

The heaviest drain is on series F and G Savings bonds, sold previous to 1952 and paying 2½ per cent. Redemptions of these bonds have been running almost \$3 billion a year. On April 30 the Treasury is withdrawing from sale 2¼ per cent series J and K Savings bonds, which were put on sale in 1952 as successors to the F and G bonds. This action will relieve future Secretaries of the Treasury of some untimely debt redemption burdens and aid the salability of marketable bonds. In the short run, however, by shutting off a source of funds, the need to raise money to cover F and G redemptions is intensified.

Here is where a second prong of the Treasury's attack is applicable. Although no decision has been announced as of this writing, Treasury officials on March 14 revealed that they may offer a long marketable bond to holders of \$1½ billion series F and G Savings bonds maturing in the balance of 1957. At some juncture an offering of marketable bonds should be made to all remaining holders of F, G, J and K bonds.

Rates Too High?

The 3% and 3½ per cent rates on the \$3 billion March borrowings are the highest the Treasury has offered on any obligations since 1933. This is an impressively long stretch, embracing the 1934-51 period when interest rates were kept artificially low by deliberate government policies. These policies were designed at first to combat economic depression, encourage borrowing and discourage saving. They were continued to cheapen war financing and protect holders of government bonds from market price depreciation. They were abandoned to enable the Federal Reserve to limit its creations of money to the legitimate needs of the economy.

Some people, when they contemplate the \$7 billion annual bill for interest on the public debt, wonder if excessive rates are not being offered. A more appropriate thought perhaps might be that we were a bit too carefree in incurring the \$275 billion federal debt. The chicken has come home to roost. Rates are higher because savers want higher rates. Lower rates can be forced on the market only by creating more money. More money in such circumstances means more inflation which erodes savings, intensifies demands for borrowed money, and eventually brings still higher rates.

One must remember that the interest received on U.S. bonds, while exempt from State and local income taxation, is fully taxable under the federal income tax laws. To earn a modest \$3,000 a year after tax, a person with no other income or resources would need to have a principal fund of no less than \$108,500 invested in U.S. bonds paying 3½ per cent.

On marketable bonds — though not on Savings bonds — there is the additional factor of risk of market price depreciation. More important, and affecting all bond holders, is the risk of dollar depreciation. When price inflation is taken into account it is dubious if the bondholder has been getting any real income at all. For example, anybody who invested \$1,000 in 2% per cent certificates of indebtedness put out by the Treasury in February 1956 found that the \$1,026.25 of

principal and interest received at maturity this February 15 would buy — on the measurement of the official consumer price index — only \$991 worth of goods and services in the market. And this calculation ignores the fact that federal income taxation may take away anywhere from 20 to 91 per cent of the interest. To provide a 2% per cent return after tax, and also make up for last year's loss in buying power of the dollar, the Government would have had to pay 7.9 per cent to a person in the first income tax bracket and 70 per cent to one in the highest tax bracket.

Experience Abroad

Outside the United States few, if any, countries today can borrow at 3% per cent or 3½ per cent. The United Kingdom in February sold £300 million 3½ per cent bonds due 1999-2004 but had to offer a bargain counter price of 80. The 20 point discount raised the offered yield to 4½ per cent. On its Savings Certificates, somewhat comparable to our Savings bonds, the United Kingdom offers 4.2 per cent free of all income tax, equivalent to 7.3 per cent before income tax at the standard rate of 42.5 per cent.

A coupon rate of 5 per cent was only one of the features designed to stimulate demand for a French Government issue of 10-year bonds early in March. To make its offering attractive France found it necessary, among other things, to exempt interest from income surtaxes for the first five years; promise a tax free bonus at maturity of at least 10 per cent and perhaps more, depending on the course of French stock prices over the life of the bonds; and include a lottery feature under which some holders of bonds would get the tax free bonus before maturity.

More and more people the world over measure interest rates against experienced annual increases in the cost of living. Savers have lost so much that they have grown wary. Shortage of capital is the common complaint almost wherever one travels. More adequate interest rates are one answer. If they bolster the savings flow and deter excessive consumption expenditures currency depreciation can be arrested. But this is not always enough. If government expenditures are running out of hand inflation may proceed and savings may be in chronically short supply.

The way to get lower interest rates is to restore belief in the wisdom of saving and lending at interest by building confidence in the future value of money. People have to feel that there is a will to protect the dollar. The critical review which the Congress is undertaking of the proposed fiscal '58 budget can save the Federal Gov-

ernment interest expense in several ways. Bigger surplus revenues can not only retire debt but relieve pressure on the money market which expresses itself in higher rates. Surplus revenues applied to income tax reductions can improve the take-home pay of investors and encourage people to save and to provide markets — directly or through investment institutions — for mortgages, corporate and government securities.

The Proliferating Public Payroll

A year or two ago the London *Economist* invented a "scientific" formula for figuring out future additions to government payrolls. The mathematical rule, capriciously labeled "Parkinson's Law," was based on two premises: officials want to multiply subordinates; and these subordinates make work for each other.

The law purports to show that the number of government employes bears no relationship to the amount of work to be done; regardless of the workload, it automatically increases at an annual rate of 5.6 per cent. In support of its law, the *Economist* noted that between 1914 and 1928 the British Navy reduced the number of its ships by two thirds and its sailors by one third. In the same period, however, the administrative staff increased by more than 78 per cent.

A recent study by the National Bureau of Economic Research, while not at all concerned with "Parkinson's Law," presents some interesting information on the growth of public payrolls in Great Britain and this country. Looking back over a 60-year span, the National Bureau finds that government in both countries "has been growing faster than any other major segment of the economy." The employment figures include members of the armed forces as well as civilian workers at the national and local level.

Between 1891 and 1950, the working population of Britain increased about 57 per cent while government employment, not including nationalized industries, went up 450 to 500 per cent. Similarly, in the U.S. between 1900 and 1950 the total labor force rose about 125 per cent while government employment jumped almost 500 per cent.

In 1891, government in Britain employed only one person out of 25 in the labor force. By 1950, one British worker in seven was on a government payroll; if nationalized industries are included the ratio increases to one out of four.

In this country in 1900, one worker out of 25 was employed by federal, state, or local governments. Fifty years later the ratio was up to one out of eight.

The Pattern of Growth

The National Bureau found a number of similarities in government employment in the two countries. For instance, in 1950 total government employment in both Britain and the U.S. was fairly evenly divided between the central government and local government bodies. There was also an almost identical increase (4½ times between 1900 and 1950) in nondefense government employes — those not in the military services or working for the military in a civilian capacity. In the U.S. nondefense workers numbered 1.1 million in 1900 and 5.2 million in 1950; in Britain the increase was from 500,000 to 2.1 million.

Moreover, of this increase in nondefense employes, national governments accounted for a growing share, most particularly after the 1930's. Commented the National Bureau:

... The central government's economic activities as regulator or producer were greatly expanded and its participation in social welfare activities augmented. In part this represented the establishment of new functions or the enlargement of old central government activities. In part it represented the assumption by the central government of functions previously handled by the local authorities. . . .

Since 1950, there have been some important developments in central government employment. In Britain, the Conservatives regained power in 1951 and promptly began to abandon or relax the myriad economic controls imposed by the Labor Government. Between April 1950 and April '55, manpower engaged in economic regulatory activities was reduced by some 37,000 — a cut of about 45 per cent. Although Britain's central government increased over-all employment by 128,000 (7.2 per cent) between 1950 and '55, the increase was due solely to defense personnel; nondefense workers declined.

In this country, the Government's armed forces more than doubled between mid-1950 and mid-1955 while federal civilian employment went up about 22 per cent. In its early years the Eisenhower Administration was successful in trimming the size of the civilian payroll — and taxes. From 2,555,930 on Executive branch payrolls at the end of January '53 the number was steadily cut until by September '54 it was down to 2,329,181 — a reduction of 226,749. Since then, however, the total has been rising. At the end of January it stood at 2,375,000, an increase of nearly 46,000 over the low-point achieved by the Administration. And the U.S. Budget Bureau estimates civilian employment will increase another 73,000 by June 30, 1958.

The Year 2069

The enlarged public payroll is one indicator of the big expansion that has taken place not only in the population of the country but also in the role of government — especially central government.

A "Parkinson's Law," as it might be applied to this country, affords opportunity for some interesting calculations. During the past 25 years, the civilian labor force has grown at the rate of 1.2 per cent a year compounded, while total government civilian employment has expanded at the rate of 3.2 per cent compounded. If these trends are projected into the future, one finds that in the year 2069 we will all be working for the government.

Lord Beveridge's Second Thoughts

In 1945, Sir William Beveridge proposed that the Government assume responsibility for seeing to it that jobs would always be abundant. In his book, *Full Employment in a Free Society*, he described full employment as always having more vacant jobs than unemployed workers and suggested: "The labor market should always be a seller's market rather than a buyer's market. . . . Jobs, rather than men, should wait."

The British Government has pursued his idea. Sir William has had the opportunity, out of ten years' personal experience and observation, to check the practical workings of the theory. In his second thoughts there is a fine lesson for Americans who advocate inflating the currency to maintain more jobs than men to fill them.

The cardinal principle of Sir William's plan was that whenever the total of public and private spending fell below the level necessary to maintain a shortage of labor the Government should step in and make up the difference. To insure "adequate total outlay" he called for the Government to expand the scope of its activities, increase its spending, adhere to a cheap money policy, and avoid "rigidly orthodox finance" because it involves "an impracticable route to full employment."

Lord Beveridge (he was elevated to the peerage in 1946) put forth his full employment plan for two reasons. He wanted to keep employment high so the famous Beveridge Plan for cradle-to-the-grave social security would not overburden the Treasury. And, thinking back to the Great Depression, he wanted to relieve people of worries about finding jobs.

The Basic Problem

However idealistic in conception, the basic difficulty with any such full employment plan is the inflation to which it gives rise. If governments spend enough, and if they fuel a boom with the high octane of easy money and credit, they can achieve conditions of full employment and labor shortage. But the worker, being human, will in these circumstances raise his wage demands. And the employer, to retain his working staff and avoid strikes, will pay more and raise the prices he charges the customer to make up the difference. Since one does not have to work hard to keep a job, the economy loses efficiency. Since savings are discouraged, funds to finance industrial progress grow scarce.

Great Britain has enjoyed — or suffered — labor shortage practically continuously during and since World War II. Official statistics show that job vacancies have far outnumbered the registered unemployed. But Lord Beveridge is witness to the fact that full employment provides no utopia. It has produced some opposite effects: insecurity for millions of people who must live on pensions or other fixed incomes or on accumulated savings. Even workers whose daily wages have kept up with the cost of living have suffered from the dwindling value of the pound. Escalator clauses do not protect the value of funds in savings accounts, life insurance, or retirement plans.

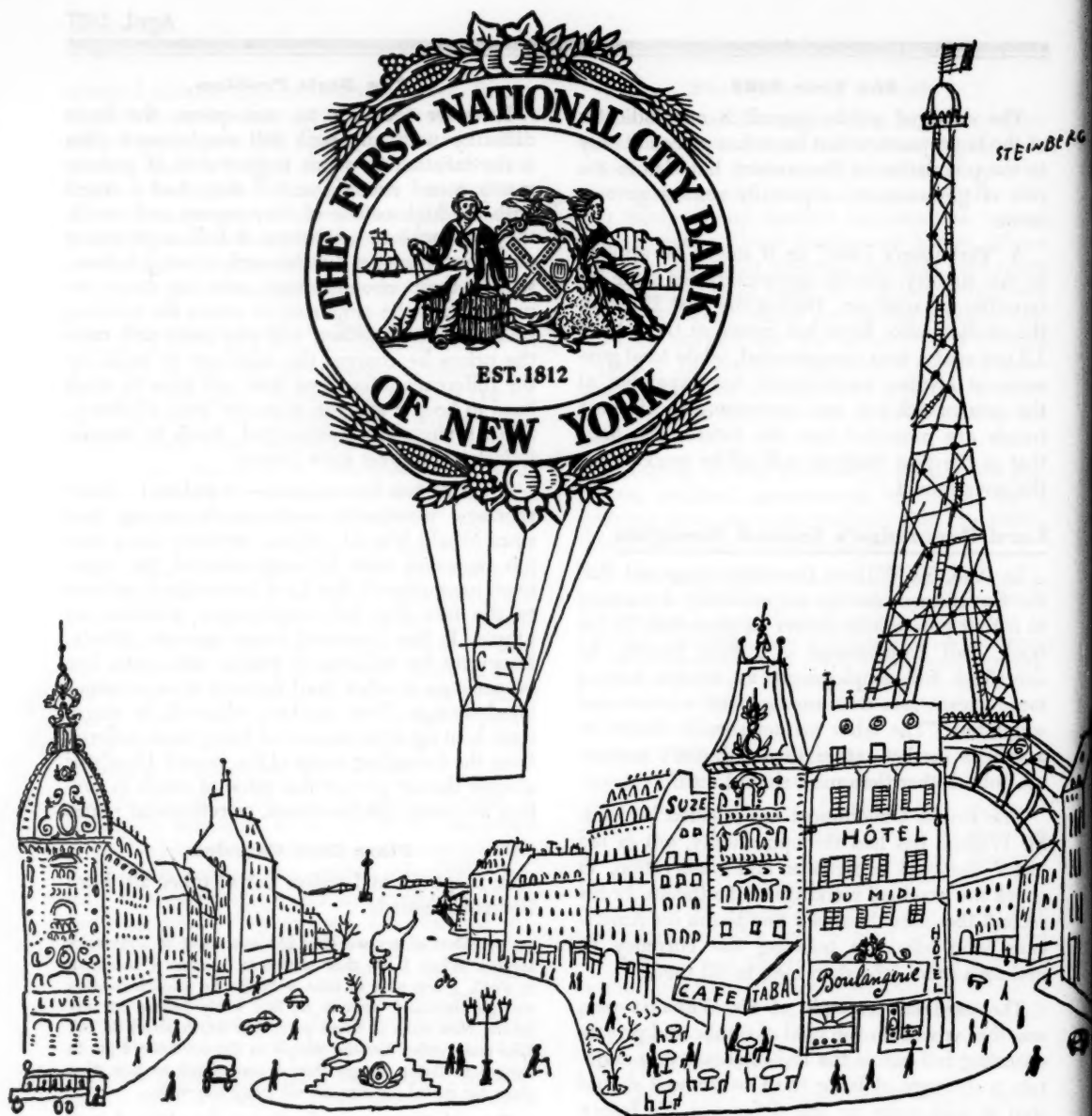
Plans Gone Haywire

In a speech in London last October 20, Lord Beveridge noted:

. . . Most of my working life was spent in University service. When I left that service to become a politician in 1945, I was able to take with me for superannuation enough thousand pounds to feel fairly happy for my future. Now each of those pounds is worth about 6s. 8d. Like many other healthy people in the seventies I am in danger of living longer than I can afford to live. Our plans for useful old age are all going hay-wire.

The underlying reason for that is the claim of each industry to fix its own money wages by sovereign action. Under full employment that is leading to destruction of the value of money, and is spreading wide-spread poverty among all who are trying to live on savings or fixed pensions. . . .

Lord Beveridge sought prosperity on a road paved with elaborate government plans and unbalanced budgets. He purposely avoided the path that over the years has proved the surest course to real economic progress. That path is one in which governments operate under the discipline of sound finance and provide the environment that encourages private enterprise and investment to go forward to the benefit of the national product and the national strength.



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